BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
RENO LIQUOR COMPANY, INC.)

Appearances:

For Appellant: Valentine Brookes and Paul E. Anderson, Attorneys at Law

For Respondent: Burl D. Lack, Chief Counsel; Crawford H. Thomas, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Reno Liquor Company, Inc., for refund of franchise tax in the amounts of $8,534.12, $13,560.01 and $11,906.67 for the taxable years ended August 31, 1947, 1948 and 1949, respectively. At oral hearing the parties agreed that the aggregate amount of the claims for refund exceed the amount of tax paid by Appellant for the years in question. It is now stipulated that the total amount in controversy is $29,821.38.

The questions presented are (1) whether Appellant was doing business in California during the years on appeal, and (2) whether Appellant's sales to Rathjen Bros., Inc., were attributable to California in computing that part of its net income which was derived from sources within the State.

In 1946 Rathjen Bros., Inc., a San Francisco distributor of I. W. Harper whiskey, wanted to obtain distributorships for certain competitive brands of whiskey. To enable it to obtain such distributorships Rathjen sought to sever its close relationship with the distiller of I. W. Harper, which was then holding in its Kentucky warehouse large stocks of I. W. Harper whiskey owned by Rathjen. For this purpose Appellant was formed under the laws of Nevada with the same officers and directors as managed Rathjen. It qualified to do business in California and established its office in San Francisco, at the office of Rathjen. It purchased from Rathjen the warehouse receipts for the whiskey in Kentucky.

Appellant then entered into an oral agreement with Rathjen in this State under which the latter was to buy at wholesale market prices "all of the whiskey which the taxpayer [Appellant] would sell to it." Pursuant to their understanding Rathjen at various times notified Appellant of the whiskey it required and Appellant ordered the distiller in Kentucky to ship it directly to Rathjen, who assumed the risk of loss and the responsibility for transportation charges.

Appellant leased warehouse space in Reno, Nevada, purchased a stock of liquor which it stored there and employed a full-time salesman there to sell the liquor at wholesale, It also sold through its Nevada salesman an unspecified quantity of its Kentucky stocks to customers situated in Nevada and Texas, Its largest customer, and its only California customer, was Rathjen. At its home office in San Francisco its officers and directors, assisted by a part-time bookkeeper, carried on all the necessary managerial functions. These functions included' meetings of directors and stockholders; obtaining loans and insurance; the receipt and handling of Rathjen's orders; the ordering of shipments from Kentucky; the receipt and deposit'of payments in bank accounts; the supervision of its two employees and the keeping of books and records. Appellant had no stocks of goods or other property of material significance in California.

The Appellant allocated its income within and without the State by a formula composed of the factors of property, payroll and sales. In employing the sales factor, it did not attribute any sales to California. The Franchise Tax Board has determined that all of the sales to Rathjen should be included as California sales in the sales factor.

The question of whether Appellant was doing business in California is governed by Section 5 of the Bank and Corporation Franchise Tax Act (now Section 23101 of the Revenue and Taxation Code), which states that the term "doing business!' means "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." Appellant contends that it did not "actively" engage in any transaction in California for the purpose of financial or pecuniary gain or profit.

The United States Supreme Court has held that an excise tax was properly imposed upon a corporation which carried on within the state managerial functions such as those engaged in by Appellant even though the corporation was formed in another state and its business of mining and

smelting was located in the other state (Cheney Bros. Co. v. Massachusetts, 246 U.S. 147, 155, 156). Similarly, in Bullfrog Goldfield Railroad Co. v. Jordan, 174 Cal. 342, the California Supreme Court held that the performance in California of the usual managerial functions by a corporation which was organized in another state and operated a railroad there, were sufficient to constitute "doing intrastate business" under a corporation license tax act which existed prior to the passage of Section 5 (Stats. 1915, p.425).

Until the year 1933, Section 5 defined "doing business" as including the mere right to do business. It may fairly be inferred that the word "actively", which was added to the section in 1933, was used in contrast to the mere right to do business. In any event, there is no basis for concluding that the section discriminates between degrees of activity. Except for the efforts of the Nevada salesman in its behalf, the Appellant performed in this State all the activities required to conduct its business. The business resulted in substantial profit and was obviously carried on for that purpose. The California activities of Appellant, therefore, did constitute "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit" as "doing business" is defined in Section 5.

Our conclusion that Appellant was doing business in California does not conflict with the regulations of the Franchise Tax Board, which are relied upon by Appellant, The regulation most favorable to Appellant's position excepts from the franchise tax "Foreign corporations which ship goods to customers in this State from points outside this State, pursuant to orders taken by agents in this State, and which neither maintain stocks of goods nor engage in other activities here ..." (Reg. 23040(b), Title 18, California Administrative Code). Appellant did engage in other activities here. Its principal office was in California and all of its activities and agents were here, with the sole exception of the Nevada salesman and his activities.

Moreover, even if the activities of Appellant had not fallen precisely within Section 5 of the Bank and Corporation Franchise Tax Act, it would appear that it would have incurred the same amount of tax liability under the Corporation Income Tax Act. That act applies to a corporation not subject to the Bank and Corporation Franchise Tax Act if it derives income from any sources in this State; that is, from any property or activities in this State, regardless of whether the activities are in intrastate, interstate or foreign commerce (Section 3 of the Corporation Income Tax Act, now Section 23501 of the Revenue and Taxation Code).

Assessments or payments of franchise tax are to be treated as having been made under the Corporation Income Tax Act if they should have been made under that act (Section 13(a) of the Bank and Corporation Franchise Tax Act, now Section 25401a of the Revenue and Taxation Code).

With respect to the question of whether Appellant's sales to Rathjen should be treated as California sales for purposes of the sales factor of the allocation formula, the focal point for consideration is the place where the activities of Appellant occurred which resulted in the sales (El Dorado Oil Works v. McColgan, 34 Cal, 2d 731, 742, dism'd. 340 U.S. 801). The only activities of Appellant in connection with these sales took place in California. It is therefore proper that the sales be attributed to this State, The fact that the activities were minimal under the arrangement with Fathjen does not justify appbrtioning the sales out of the State.

Appellant calls attention to a practice of the Franchise Tax Board of assigning only 50 percent weight to sales of war materiel under government contracts where the taxpayer was also engaged in selling civilian goods. It argues that this situation is similar in that a minimum of sales activity was required for the Rathjen sales. According to the Franchise Tax Board, its practice was never extended beyond the limited circumstances above described. It states that it has never used a similar rule in other cases where solicitation of sales was at a minimum, as, for example, where automobiles, appliances and other items, including whiskey, were in short supply after the war, It does not appear that there has been any discrimination against the Appellant and,, in our opinion, the formula as applied by the Franchise Tax Board in this case was fairly calculated to arrive at a proper allocation of the income.

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of Reno Liquor Company, *Inc.*, for refund of franchise tax in the amounts of $8,534.12, $13,560.01 and $11,906.67 for

the taxable years ended August 31, 1947, 1948, and 1949, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 17th day of February, 1959, by the State Board of Equalization,

Paul R. Leake, Chairman

Geo. R. Reilly, Member

John W. L nch, Member

Richard Nevins, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary